Summary of the Monetary Policy Committee Meeting

3 May 2023, No: 2023-19

Meeting Date: 27 April 2023

Inflation Developments

1. In March, consumer prices increased by 2.29%, while annual inflation decreased by 4.67 points to 50.51%. Annual inflation decreased across all groups, being more pronounced in the energy group. On a monthly basis, the food and services groups stood out with price increases. Supported by the significant fall in energy prices, the rise in producer prices remained limited and the decline in annual producer inflation was sustained in March. Against this background, seasonally adjusted B and C core indicators have recorded the lowest monthly increase since October 2021, while annual inflation receded in both indicators.

2. Prices of the food and non-alcoholic beverages group increased by 3.84% in March, while annual inflation in this group fell by 1.44 points to 67.89%. Annual inflation dropped by 0.19 points to 65.94% in unprocessed food and by 2.19 points to 71.68% in processed food. Seasonally adjusted data point that prices of fresh fruits and vegetables decreased in March, more visibly in vegetables. Price developments excluding fresh fruits and vegetables reveal that red meat and white meat as well as related processed food items diverged with price increases. On the other hand, non-alcoholic beverages and fruit juices, sugar and related products as well as eggs were other items that stood out. Meanwhile, price increases continued in the bread and cereals group in March.

3. Energy prices rose by 0.38% on a monthly basis, while annual inflation in this group dropped by 14.35 points to 35.66%. Receding international energy prices coupled with the stable course of exchange rates led to moderate price movements across the group in March. Municipal water tariffs diverged from the group’s outlook with a price increase (1.97%). The mild course in the group’s prices is projected to continue due to the reduction in residential electricity tariffs in April and the expected fall in residential natural gas bills in the period ahead.

4. Prices in the services group increased by 3.08% while the group's annual inflation decreased by 1.71 points to 59.93%. In this period, annual inflation declined in restaurants-hotels, communication, other services, and particularly in transport, while it recorded an increase in rents. The rent and restaurants-hotels subgroups stood out with monthly price increases. Prices in transport services edged up by 1.01% amid the positive outlook for fuel prices, while annual inflation in this subgroup declined by 13.15 points to 57.12%. The outlook for food, particularly red meat prices, brought prices of restaurants-hotels up (3.85%), pulling the subgroup’s annual inflation down by 3.61 points to 70.73%. Other services prices were up by 2.65% in March, driven by package tours and education services due to higher private school fees. The monthly increase in the rent subgroup accelerated by 4.89%, and the group's annual inflation reached 62.76%.

5. Annual inflation in core goods declined by 4.48 points to 36.58%. Annual inflation fell across subgroups in March. Prices of durable goods (excluding gold) rose by 1.67% month-on-month, and the subgroup's annual inflation dropped by 4.72 points to 40.21%. In durable goods, the furniture item stood out with price increases, while prices of white goods and automobiles rose relatively moderately. In other core goods, prices edged up by 2.52%, while annual inflation fell by 4.00 points to 44.48%. In this period, following the regulation in legal profitability scales at mid-month, medicine prices increased by 5.38%, led by low-priced products. The effects of this increase in medicine prices are expected to carry over into April. Household cleaning products were another item that came to the forefront in the subgroup with price increases in March. Prices in the clothing and footwear subgroup went down by 2.02% due to the ongoing seasonal discounts unlike previous years. Accordingly, annual inflation in this subgroup dropped by 4.45 points to 16.26%.
6. According to the April results of the Survey of Market Participants, the 12-month ahead inflation expectation decreased by 0.61 points to 31.02%. The 24-month ahead inflation expectation was revised down by 0.37 points to 17.54%. The five-year ahead inflation expectation, on the other hand, was measured as 9.03%.

Factors Affecting Inflation and Risks

7. Although recently released data point to a stronger economic activity than anticipated, recession concerns in developed economies as a result of geopolitical risks and interest rate hikes continue, and conditions threatening financial stability, triggered by successive bank failures, have emerged.
8. While the negative consequences of supply constraints in some sectors, particularly basic food, have been alleviated by the strategic solutions facilitated by Türkiye, the high level in producer and consumer inflation continues on an international scale. The effects of high global inflation on inflation expectations and international financial markets are closely monitored.
9. While the divergence in monetary policy steps and communications of central banks in advanced economies continues due to their diverse economic outlook, coordinated steps are taken that prioritize financial stability through swap agreements and new liquidity facilities. Financial markets have been adjusting their expectations that the central banks would end the rate hike cycles in the near term.
10. Regarding portfolio flows to emerging economies, bond and equity markets saw inflows in April parallel to the improvement in the global risk appetite. In the meantime, the volatility in the long-term bond yields in advanced economies and the course of global financial conditions keep the risks to portfolio flows to emerging economies alive.
11. In March, international commodity prices posted a decline that spread across subgroups. Global food prices continued to decrease led by cereals and vegetable oils. After having dropped in March, crude oil prices increased in early April following the OPEC's quota cut decision, but prices returned to their pre-decision levels by the end of the month. The downward trend in international natural gas prices continued in April, albeit at a slower pace. Accordingly, domestic industrial natural gas tariffs were reduced further in April. While the indicator regarding the pressures on the global supply chain hovered below its historical trend, domestic problems faced after the earthquake were largely eliminated by March. The favorable outlook of international transportation costs was maintained in March. Against this background, producer prices increased slightly by 0.44%, led by the energy group, and the downward trend in annual producer inflation continued.

12. While level and underlying trend of inflation have been improved with the support of the implemented integrated policy approach, the effect of earthquake-driven supply-demand imbalances on inflation is closely monitored.

13. Before the disaster of the century, leading indicators have been pointing to a stronger domestic demand compared to foreign demand as well as an increase in the growth trend in the first quarter of 2023. Following the rise in January, the seasonally and calendar adjusted industrial production index declined by 6% on a monthly basis in February due to the earthquake. In the January-February period, industrial production edged down by 0.4% in quarterly terms. Meanwhile, the seasonally and calendar adjusted retail sales volume index increased by 5.1% on a quarterly basis in the January-February period despite having decreased on a monthly basis in February following the strong rise in January. Other indicators of consumption demand and the survey data suggest that production and consumption, which dropped due to the disaster-related effects in February, posted a strong recovery trend in March that was driven more by domestic demand than foreign demand.

14. The impact of the earthquake on production, consumption, employment and expectations is being extensively evaluated. While the earthquake is expected to affect economic activity in the near term, it is anticipated that it will not have a permanent impact on the performance of the Turkish economy in the medium term.

15. Leading indicators show that the economic activity in the earthquake zone has been recovering faster than expected. Credit card expenditures continued to recover towards pre-disaster levels as of end-March in the most severely affected provinces, while they exceeded pre-disaster levels in other provinces in the disaster zone. Similarly, in seasonally adjusted terms, after a decline in February, exports from the disaster zone in March converged to their pre-disaster level. An analysis of the Business Tendency Survey (BTS) data by provinces reveals that production and demand expectations also increased in March in provinces with high economic weight in the disaster area. Detailed information derived from field interviews also confirms that the strong recovery trend in the disaster area continues.

16. After a rise in January, seasonally adjusted employment declined in February, but increased by 0.8% (260 thousand people) on a quarterly basis in the January-February period. In February, the unemployment rate rose by 0.3 percentage points to 10% due to the decline in the seasonally adjusted labor force participation rate as well as the decrease in employment. On a quarterly basis, the labor force participation rate increased by 0.2 points quarter-on-quarter to 53.9% in the January-February period, while the unemployment rate fell by 0.3 points to 9.9%. The impact of the earthquake on the labor market in the disaster zone will be evaluated more clearly in the coming months. Along with the flow of data on employment, survey indicators and high-frequency data are also closely monitored. Data on employment expectations, job vacancies and job applications suggest that despite a limited deceleration in the aftermath of the disaster, the upward trend in employment has been maintained across the country owing to the strong recovery that followed the deceleration.

17. While share of sustainable components of economic growth remains high, the stronger-than-expected contribution of tourism revenues to the current account balance continues throughout the year. On the other hand, domestic consumption demand, high level of energy prices and the weak economic activity in main trade partners keep the risks on current account balance alive. Despite the widening foreign trade deficit in consumption goods, the decline in energy imports and the ongoing upward trend in services revenues continue to support the current account balance. Meanwhile, gold imports have been decelerating over the last few weeks. Sustainable current account balance is important for price stability.

Monetary Policy

18. The monetary policy stance will be determined by taking into account the evaluations on the source and permanence of risks, along with the extent to which they can be contained by monetary policy, and with a focus on achieving the sustainable price stability target, in a cautious manner.

19. In formulating the monetary policy towards achieving the sustainable price stability objective, a liraization-oriented approach will be maintained that also addresses risks to financial stability. The rate of credit growth and allocation of funds for real economic activity purposes are closely monitored.

20. The Committee will prioritize the creation of supportive financial conditions in order to minimize the effects of the disaster and support the necessary recovery. It has become even more important to keep financial conditions supportive to preserve the growth momentum in industrial production and the positive trend in employment after the earthquake. Accordingly, the Committee has decided to keep the policy rate unchanged. The Committee assessed that the current monetary policy stance is adequate to support the necessary recovery in the aftermath of the earthquake by maintaining price stability and financial stability. The effects of the earthquake in the first half of 2023 will be closely monitored.

21. The CBRT will implement Liraization Strategy in order to create an institutional basis for permanent and sustainable price stability. As announced in the 2023 Monetary Policy and Liraization Strategy document, the Committee will continue to decisively use the tools supporting the effectiveness of the monetary transmission mechanism and the entire policy toolset, particularly funding channels, will be aligned with liraization targets. The focus of this process will be on developing policy instruments to support the improvement of Turkish lira deposits, to increase Turkish lira-denominated assets in the collateral structure of Open Market Operations funding, to reduce the weight of swaps in the composition of funding, and to strengthen foreign exchange reserves.

22. The rise in the demand for long-term, fixed-income and Turkish lira-denominated assets and the course of the yield curve in tandem with the direction of the efficiency of monetary transmission are closely monitored. Along with credit growth, the Committee will also consider the improvement in financing costs of loans providing efficiency gains in targeted areas so as to maintain the transmission.

23. Accordingly, the effects of liquidity and distribution developments of the Turkish lira on deposits and loan pricing, the effects of exchange rate developments on inflation, and the impact of the developments regarding FX-protected deposit products on reverse currency substitution, the depth and stability of the foreign exchange market, and price stability are being analyzed, and necessary policy measures are being taken.

24. The CBRT will continue to use all available instruments decisively until strong indicators point to a permanent fall in inflation and the medium-term 5 percent target is achieved in pursuit of the primary objective of price stability.

25. Stability in the general price level will foster macroeconomic stability and financial stability through the fall in country risk premium, continuation of the reversal in currency substitution and the upward trend in foreign exchange reserves, and durable decline in financing costs. This would create a viable foundation for investment, production and employment to continue growing in a healthy and sustainable way.

26. The Committee supports building strong policy coordination and a holistic macro policy mix involving all stakeholders in order to achieve price stability.

27. The Committee will continue to take its decisions in a transparent, predictable and data-driven framework.